Office of Chief Counsel
Internal Revenue Service
Memorandum
CC:LM:FS:BOS:POSTF-119598-02
MJGormley

date: MAY 28 2002

to: District Director, New England District
Attn: [redacted], Team Manager, Group [redacted]

from: Associate Area Counsel, (LMSB)
Area 1

subject: [redacted]
U.I.L. Nos. 761.01-02 and 6501.04-03

This is in response to your request for advice dated April 1, 2002, regarding the validity of [redacted]'s [redacted] partnership return and whether or not the return was sufficient to start the running of the statute of limitations. This memorandum should not be cited as precedent.

ISSUES

1. Whether [redacted] fulfilled all the necessary requirements to elect to be excluded from the provisions of subchapter K in accordance with I.R.C. § 761 and Treasury Regulation § 1.761-2(b)(2).

2. Whether a tax return sufficient to start the running of the applicable statute of limitations has been filed.

CONCLUSION

1. [redacted] was not an eligible entity for purposes of I.R.C. § 761(a) and could not elect to be excluded from the application of the subchapter K provisions pursuant to I.R.C. § 761.

2. The document filed by [redacted] the Form 1065, did not satisfy the elements of a return for statute of limitations purposes. Moreover, the relevant return for determining whether the I.R.C. § 6501(a) limitations period has run is the individual partner's return, the Forms 1120 for [redacted] Finally, [redacted] failed to properly file the return, based on the filing of the Form 1065 with the wrong Service Center.

FACTS

The facts set forth below, and upon which this advice is based, are as stated by your office. If our understanding of the facts is not correct, or if the facts have changed in any way, you should not rely on this advice but rather seek modified advice based on the changed circumstances.

This case involved the purported purchase of a [redacted] by a foreign sales corporation for the taxable year [redacted] followed by the lease of that [redacted] to an unrelated lessee for use outside the United States. On or about [redacted], entered into an agreement with [redacted], [redacted] Manufacturer, to purchase several new [redacted]. [redacted] made a deposit of $[redacted] with [redacted] at the time of the contract signing and made additional payments prior to completion of the [redacted]. After construction of [redacted] was completed and a delivery date was set, [redacted] sought to arrange financing [redacted].

To facilitate financing [redacted], [redacted] was formed under the Delaware Revised Uniform Limited Partnership Act (RULPA). [redacted], a Massachusetts corporation, is a wholly owned corporation of [redacted] is the parent company of a number of domestic subsidiaries and files a consolidated Federal income tax return with [redacted]. [redacted] is a [redacted] Bank. [redacted] is a Delaware corporation and a wholly owned subsidiary of [redacted]. [redacted] and [redacted] held all of the outstanding shares of [redacted] a foreign sales corporation incorporated in [redacted]. In [redacted], [redacted] contributed their shares in the FSC to form [redacted], an unincorporated organization. [redacted] was a [redacted]% limited partner and a [redacted]% general partner. [redacted] was governed by the Limited Partnership Agreement dated [redacted]. The agreement specifically stated that the partners intended that the unincorporated organization be an investing partnership as defined in Treas. Reg. § 1.761-2(a)(2), and intended for the investing partnership to elect to be excluded from the application of the Subchapter K provisions pursuant to § 761.

In a memorandum dated [redacted], this office advised you that [redacted] was not eligible to make such an election. This decision was based on the fact that the partners in [redacted] were not co-owners of the partnership property under the I.R.C. § 761 regulations. Since this determination was made, the taxpayer has provided the Service with documentation which it claims supports a finding that it filed a Form 1065, partnership return, electing to be excluded from the provisions of Subchapter K.[1]

Specifically, the taxpayer has provided the Service with a copy of a cover letter dated [redacted], addressed to the Internal Revenue Service, [redacted], signed by [redacted], Vice President of [redacted]. The letter references certified mail #[redacted]. The letter states that she is enclosing Form 1065 for [redacted] for three partnerships, including [redacted], [redacted], [redacted], [redacted], and [redacted] ("[redacted]"), [redacted]. The letter states no tax is due with these returns. Attached to the letter is a copy of a Form 1065, U.S. Partnership Return of Income for [redacted] for each of the above identified partnerships. The name and address of the partnership is provided, along with the partnership's identification number, and the date business was started: [redacted] for [redacted]; [redacted] for [redacted]; and [redacted] for [redacted]. Each return is signed by [redacted] and dated [redacted]. On lines 8 and 9c, each return bears the handwritten notation "See attached election". Page 2 of the Form 1065 is attached. However, all of the entry lines are blank, and no information was provided concerning the income and expenses of the partnerships.

Attached to each of the Form 1065 is a copy of a Form 8736, Application for Automatic Extension to File U.S. return for a Partnership, REMIC, or for Certain Trusts, along with a cover letter dated [redacted], enclosing the extension application. The cover letter enclosing the application for automatic extension is addressed to the Internal Revenue Service Center, [redacted]. The Application itself contains the name, address and identification number of each partnership. An automatic three month extension is requested to file a Form 1065 for the tax year beginning [redacted] and ending [redacted] for [redacted]; the tax year beginning [redacted] and ending [redacted] for [redacted]; and the tax year beginning [redacted] and ending [redacted] for [redacted]. Each Application is signed by [redacted], Vice President, and

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[1] Complete copies of all documentation provided by the taxpayer are enclosed with this memorandum.

dated [redacted].

Also attached to the Form 1065 is a one page statement, identifying each partnership by name and identification number, entitled "Statement under I.R.C. § 761". The Statement is broken down into five sections and provides the partnership's name and address, the names, addresses and identification numbers of all partners, a statement that the partnership qualifies under Treasury Regulation § 1.761-2(a)(1) and (2) as an investing partnership and that all of its members elect to exclude the partnership from subchapter K. A notation was also made providing the address at which a copy of the partnership operation agreement was available.

Also contained in the documentation package provided by the taxpayer is a copy of a letter dated [redacted] to the [redacted] Department of Revenue in [redacted] enclosing the state income tax returns for [redacted] and [redacted] signed by [redacted], senior Vice President of [redacted] and a copy of a similar letter dated [redacted] to the Delaware Department of Revenue enclosing the state income tax returns for all three of the partnerships. Copies of all three state returns have been provided. Each contains much of the same information provided on the federal Form 1065 and references an attached election. Each state return has a copy of the federal Form 1065 and Application for Automatic Extension attached, along with the Election Statement. Various copies of "Tax Return Docket" sheets for each partnership has also been provided. This references each partnership, the original due date of the return, whether an extension has been granted, and the initials of the preparer of the return and the reviewer. The "Tax Return Docket" sheet contained in the documentation package for [redacted] is for the [redacted] state return; while the [redacted] package has a "Tax Return Docket" sheet for the [redacted] state return and the Form 1065 subchapter K election. The "Tax Return Docket" sheet contained in the documentation package for [redacted] is for the Form 1065.

Attached to the [redacted] and [redacted] packages is a three page typewritten statement about the election out of subchapter K. It is dated [redacted], Corporate Tax, [redacted], and although unsigned, contains the name [redacted] in a signature block section at the end of the third page. This typewritten statement discusses the three partnerships electing out of subchapter K, the partnerships' eligibility for the election, the mechanics of the election, the effect of the election and the filings and tax information requirements.

The Service's microfiche records contain entries showing [redacted] filed for an extension of time to file a return on [redacted] and they were granted an extension to [redacted]. There is also an entry for [redacted] that indicates a remittance has been submitted with a return but there is a [redacted] entry for the amount of the remittance. Finally, tax per the return of [redacted] was assessed on [redacted].

The losses from the leasing arrangement were reported on the respective Forms 1120 of [redacted] and [redacted]. The Service has obtained restricted consents to extend the statute of limitations on assessment and collection for [redacted] for the years at issue. No subsequent partnership returns have been filed. Following the Service's determination that [redacted] was not eligible to make an I.R.C. § 761(a) election to be excluded from the provisions of subchapter K, the taxpayer has alleged the statute of limitations for [redacted]'s [redacted] year has expired based on the filing of the above-described Forms 1065 that accompanied the subchapter K elections for each partnership.

LEGAL ANALYSIS

Issue 1:

Whether [redacted] fulfilled all the necessary requirements to elect to be excluded from the provisions of subchapter K in accordance with I.R.C. § 761 and Treasury Regulation § 1.761-2(b)(2).

Discussion

I.R.C. § 761(a) defines the term partnership for purposes of the Subchapter K partnership rules as including a syndicate, group pool, joint venture or other unincorporated organization through or by means of which any business financial operation or venture is carried on, and which is not a corporation, a trust or an estate. In addition, the Service has determined that mere co-ownership of property that is maintained, kept in repair, and rented or leased is not a partnership.

I.R.C. § 761(a) also provides, in part, that under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of Subchapter K, if the organization is availed of for investment purposes only and not *for the active conduct of a business.*[2] *The members of the* organization must be able to compute their income without the *necessity of computing partnership taxable income.*

For an unincorporated organization to be able to elect to be excluded from the application of the provisions of Subchapter K as an investing partnership under § 761, the participants must:

(1) own the property as co-owners;
(2) reserve the right separately to take or dispose of their shares of any property acquired or retained; and
(3) not actively conduct business or irrevocably authorize some person or persons acting in a representative capacity to purchase, sell or exchange such investment property, although each separate participant may delegate authority to purchase, sell, or exchange his share of any such investment property for the time being for his account, but not for a period of more than a year.

See Treas. Reg. § 1.761-2(a)(2). The Service has ruled that co-ownership is determined under state law, not by the definition of a co-tenancy, but rather by reference to each party's rights in the property as specified by a lease or other contract between the parties.

Under RULPA, partners of a limited partnership own partnership interests in that partnership. Partnership interests are personal property that consists of the right to a share of the profits and surplus of the partnership. Ownership of a partnership interest generally does not give a partner the right to take separately or dispose of its share of partnership property. Partners in a partnership under RULPA are not co-owners of partnership property and cannot take their share of partnership property at will.

§ 1.761-2(b)(2) of the Treasury Regulations provides that an eligible unincorporated organization must make the election provided in § 761(a) in a statement attached to, or incorporated in, a properly executed partnership return, Form 1065, which shall contain the required information prescribed under the

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[2] § 1.761-2(a) of the Treasury Regulations also allows the members of an unincorporated organization to elect to be excluded from the application of all or part of Subchapter K, if the organization is availed of for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted.

regulations. Such return shall be filed with the internal revenue officer with whom a partnership return, Form 1065, would be required to be filed if no election were made. The partnership return must be filed not later than the time prescribed by Treas. Reg. § 1.6031-1(e)(including extensions thereof) for filing the partnership return with respect to the first taxable year for which the exclusion from Subchapter K is desired.

In the alternative, an unincorporated organization may be deemed to have made the election pursuant to § 761 if it can show from all the surrounding facts and circumstances that it was the intention of the members of such organization at the time of its formation to secure exclusion from the application of all of Subchapter K beginning with the first taxable year of the organization. See Treas. Reg. § 1.761-2(b)(2)(ii). The regulations provide that although the following facts are not exclusive, either one of such facts may indicate the requisite intent:

> (A) At the time of the formation of the organization there is an agreement among the members that the organization be excluded from Subchapter K beginning with the first taxable year of the organization, or
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> (B) The members of the organization owning substantially all of the capital interests report their respective shares of the items of income, deductions, and credits of the organization on their respective returns (making such elections as to individual items as may be appropriate) in a manner consistent with the exclusion of the organization from Subchapter K beginning with the first taxable year of the organization.

Treas. Reg. § 1.761-2(b)(2)(ii).

As noted, at the time this issue was first considered by the Service, the taxpayer had not been able to produce the written § 761(a) election. Accordingly, the Service looked to all the surrounding facts and circumstances to determine whether the parties possessed the requisite intent to elect out of subchapter K. Under the facts as stated above, the terms of the Limited Partnership Agreement explicitly stated that the partners intended that [redacted] be an investing partnership as defined in Treas. Reg. § 1.761-2(a)(2), and intended for [redacted] to elect to be excluded from the application of the Subchapter K provisions pursuant to I.R.C. § 761. Nevertheless, because [redacted] was a limited partnership formed under RULPA, the partners were not considered to be co-owners of the partnership property and thus, [redacted] was not an eligible entity for purposes of I.R.C. § 761(a). Based on all of the above, the Chief Counsel's Office determined that [redacted] may not elect to be excluded from the application of the Subchapter K provisions pursuant to I.R.C. § 761. Moreover, [redacted] did not qualify as a small partnership under the I.R.C. § 6231(a)(1)(B)(i) definition because the partners include corporations. As such, [redacted] was determined to be subject to both the Subchapter K provisions and TEFRA proceedings.

This determination must now be reviewed in light of the documentation provided by the taxpayer to support its claim that it filed a written election to be excluded from the subchapter K provisions. An organization eligible to elect exclusion from subchapter K must file a Form 1065 for the first year for which the organization wishes to make the election. Treas. Reg § 1.6031-1(b)(1); Treas. Reg. § 1.761-2(b)(2)(ii). The election must be filed within the time prescribed for filing the partnership return, including extensions,[3] with the IRS district where a partnership return would be filed if no election were made. Instead of the information requested in the Form 1065, the organization should attach a statement to the Form 1065 containing the following information:

(1) the name or other identification of the organization;
(2) the address of the organization;
(3) the names, addresses and identification numbers of all the members of the organization;
(4) a statement that the organization is eligible for exclusion under I.R.C. § 761(a)(1)(relating to investment organizations), I.R.C. § 761(a)(2)(relating to joint production or extraction organizations), or I.R.C. § 761(a)(3)(relating to securities syndicates;
(5) a statement that all of the members of the organization elect that it be excluded from all of subchapter K; and
(6) a statement indicating where a copy of the agreement under which the organization operates is available, or if the agreement is oral, a statement indicating from whom the provisions of the agreement may be obtained.

Based on the documentation recently provided by the taxpayer, it appears [redacted] fulfilled all of the requirements of

[3] The due date for a partnership return is generally the fifteenth day of the fourth month following the close of the partnership year. Treas. Reg. § 1.6031-1(e)(2).

Treas. Reg. § 1.761-2(b)(1) and (2). However, this does not change the fact that because [redacted] was a limited partnership formed under RULPA, the partners were not considered to be co-owners of the partnership property and thus, [redacted] was not an eligible entity for purposes of I.R.C. § 761(a). [redacted] may not elect to be excluded from the application of the Subchapter K provisions pursuant to I.R.C. § 761. Moreover, [redacted] did not qualify as a small partnership under the I.R.C. § 6231(a)(1)(B)(i) definition because the partners include corporations. As such, [redacted] is still subject to both the subchapter K provisions and TEFRA proceedings.

Issue 2:

Whether a tax return, sufficient to start the running of the applicable statute of limitations, has been filed.[4]

Discussion

I.R.C. § 6501(a) generally provides that the Service has three years after a return is filed in which to assess any tax due, or in which to start any proceeding in court to collect such tax. The running of the three year period of limitations depends upon the proper filing of a return, which requires a determination of whether the document which was delivered (i) constitutes a return and (ii) whether the document is deemed to have been filed.

The term "return" is not defined in I.R.C. § 6501. However, the regulations under I.R.C. §6011(a) provide that "each taxpayer must carefully prepare their return and set forth fully and clearly the information required to be included therein. Returns which have not been so prepared will not be accepted as meeting the requirements of the Code." Treas. Reg. § 1.6011-1(b). The elements of a return for statute of limitations purposes are: (1) There must be sufficient data to calculate a tax liability; (2) The document must purport to be a return; (3) There must be an honest and reasonable attempt to satisfy the requirements of the

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[4] The statute of limitations is an affirmative defense and the party pleading it bears the ultimate burden of proof. Tax Court Rule 142(a); Coleman v. Commissioner, 94 T.C. 82, 89 (1990). Moreover, statutes of limitations sought to be applied to bar the rights of the Government receive strict construction against the moving party. E.I. du Pont de Nemours & Co. v. Davis, 264 U.S. 456, 462 (1924).

tax law; and (4) The taxpayer must execute the return under the penalties of perjury. Beard v. Commissioner, 82 T.C. 766 (1984). The taxpayer may secure the benefits of the period of limitations only upon "meticulous compliance" with all named conditions. Lucas v. Pilliod Lumbar Co., 281 U.S. 245, 249 (1930), citing Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930). The return need not be perfectly accurate or complete. It must however purport to be a return, be sworn to, and evidence a genuine attempt to satisfy the law. Zellerbach Paper Co. v. Helvering, 293 U.S. 172 (1934).

In this case, taxpayer, [redacted] contends that the Form 1065 filed by [redacted] for the taxable year [redacted] was sufficient to start the period of limitations under I.R.C. § 6501(a) running. It is clear the Form 1065 filed by [redacted] was intended to serve as an accompaniment to the election. In compliance with the requirements of Treas. Reg. § 1.761-2(b)(2)(i), instead of the information requested on the face of the Form 1065, [redacted] attached a statement to the return containing only the information necessary to make the election.[5] While the return in this case appeared to meet the requirements of the regulation for purposes of making the I.R.C. § 761 election, it did not contain sufficient data to calculate a tax liability and did not purport to be an actual return. It was an identifying document that accompanied the election and was filed along with a request for an automatic extension of time to file the return itself. While the filing of a return that is defective or incomplete may be sufficient to start the running of the statute of limitations, such a defective or incomplete return must purport to be a specific statement of items of income, deduction and credit in compliance with the Code. Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930). This Form 1065 contained no tax information. Further, although [redacted] filed a request for extension of time to file the actual return, the filing of the extension request did not start the running of the statute of limitations. Id.

Alternatively, assuming the Form 1065 was somehow sufficient on its face and did qualify as a "return" within the meaning of

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[5] This included the partnership name and address; the names, addresses and identification numbers of all the partners; a statement of eligibility and consensus among the partners regarding exclusion from the provisions of subchapter K; and, the location where a copy of the partnership agreement could be obtained.

the Code and applicable regulation sections, we must still resolve the issue of whether the I.R.C. § 6501(a) limitations period would begin running from the filing date of the partnership return or instead, from the filing date of the partner's return, if such a return had been filed. Stated more generally, the issue is whether the "return" referenced in I.R.C. § 6501(a) is that of the taxpayer or [redacted] as the source entity from which the taxpayer's tax items would derive. See Lardas v. Commissioner, 99 T.C. 490 (1992). If the taxpayer's return is that return referenced by the § 6501(a), the statute of limitations has not yet run. If, however, the named return is the Form 1065 filed by [redacted], and assuming that Form 1065 qualifies as a return, the period for assessing the partnership has expired.

As noted, the "return" purportedly filed by [redacted] was a partnership return. The actual tax liabilities of the taxpayer, [redacted], will only be determined after taking into account items of income, deduction and credit passed-through from the partnership return. Here, the plain language of I.R.C. § 6501(a) supports the view that the limitations period would run from the filing date of the partner's return since the Commissioner could only determine whether to assess a deficiency against the taxpayer after examining the taxpayer's return. Any errors on the partnership return would not effect the tax liability of the partnership and the Commissioner could assess a deficiency against only a partner who claimed the benefit of those errors. Moreover, the partnership return did not contain all the information necessary to compute the partner's taxes and as noted above, tax returns that lack the data necessary for the computation and assessment of deficiencies do not trigger the period of assessment. See Bufferd v. Commissioner, 506 U.S. 523 (1993).

In Bufferd, the Supreme Court specifically resolved the issue of whether a passthrough entity's period for assessment controls the Commissioner's ability to make adjustments for individual taxpayers, e.g. shareholders. The Court also held that the relevant return for purposes of I.R.C. § 6501(a) is the return of the taxpayer against whom a deficiency is being asserted. 506 U.S. at 527. This has been held true regardless of the source entity. See Lardas, 99 T.C. at 493 citing inter alia Bufferd, T.C. Memo 1991-170, aff'd 952 F.2d 675 (2nd Cir. 1992), cert. granted 505 U.S. 1203 (Subchapter S corporation); Siben v. Commissioner, T.C. Memo 1990-435, aff'd 930 F.2d 1034 (2nd Cir. 1991), cert. den. 502 U.S. 963 (partnerships); Stahl v. Commissioner, 96 T.C. 798 (1991)(complex trust); Bartol v.

Commissioner, T.C. Memo 1992-141(grantor trust).

In Siben, supra, the Commissioner obtained consents to extend the statute of limitations on assessment from the taxpayers, members of a partnership. The Commissioner did not obtain an extension from the partnership itself. Following the issuance of deficiency notices to the taxpayers, the individual partners argued the statute of limitations on assessment and collection was governed by the partnership return and had expired prior to the issuance of the notices of deficiency. The Court found the statute of limitations was governed by the partners' individual income tax returns, rather than the partnership return because the partnership was not a taxable entity. Although a properly completed Form 1065 would contain details regarding any transactions resulting in income or loss to be passed through to the partners, "'persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities,' and it is the individual partner's income tax return that furnishes the information necessary to calculate that tax." Siben, 930 F.2d at 1035, citing I.R.C. § 701.[6] A partnership return does not report any tax imposed under the Code and it does not furnish any information necessary to calculate a partner's income tax, i.e., marital status, exemptions and income, loss, deductions and credits from sources other than the partnership. Siben, 930 F.2d at 1036. Accordingly, a partnership return such as [redacted]'s Form 1065 could not qualify as a return under I.R.C. § 6501(a) that would trigger the statute of limitations on assessment. See also Durovic v. Commissioner, 487 F.2d 36, 38-40 (7th Cir. 1973), cert. den. 417 U.S. 919 (1974). It should also be noted that as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)[7], Pub. l. No.97-248, § 402, 96 Stat. 324, 648, Congress provided "[e]xcept in the case of Federally registered partnerships, the date of filing of the partnership return does not affect the individual partner's period of limitations." H.R. Conf. Rep. No. 760, 97th Cong., 2d sess. 599, reprinted in 1982 U.S. Code Cong. & Admin. News 1190, 1371.

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[6] The Siben court noted a partnership is not a taxable entity under the Code and therefore the return required to be filed by a partnership is not an income tax return. Rather, it is an information return. 930 F.2d 1035, citing estate of Klein v. Commissioner, 537 F.2d 701, 704 (2nd Cir. 1976) cert. den. 429 U.S. 980 (1976).

[7] Based on our conclusion in Issue 1, [redacted] is still subject to the provisions of subchapter K and TEFRA proceedings.

CONCLUSION

[redacted] was not an eligible entity for purposes of I.R.C. § 761(a) and could not elect to be excluded from the application of the subchapter K provisions pursuant to I.R.C. § 761. Accordingly, [redacted] is still subject to the provisions of subchapter K and TEFRA proceedings. Therefore, [redacted] was required to file a timely partnership return, Form 1065, for the taxable year ending [redacted]. The document filed by [redacted], the Form 1065, did not satisfy the elements of a return for statute of limitations purposes. Therefore, the statute of limitations period for the partnership has not yet begun to run. Moreover, the relevant return for determining whether the I.R.C. § 6501(a) limitations period has run for purposes of any proposed tax adjustments is the individual partner's return, the Forms 1120 for [redacted]. The Service has obtained restricted consents to extend the statute of limitations on assessment and collection for [redacted] for the year at issue and the statute remains open.

We note this case has been coordinated with Diane C. Mirabito, Industry Counsel, LMSB, Area 1. If you need further assistance, please contact the undersigned at 617/565-7858.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

DAVID N. BRODSKY
Associate Area Counsel (LMSB)
Area 1, Financial Services

By: /S/ MJGORMLEY
MICHELE J. GORMLEY
Senior Attorney

cc: Roland Barral
Area Counsel (LMSB)
Area 1, Financial Services

Nancy Knapp
Senior Legal Counsel (LMSB)
Area 1, Financial Services

Diane C. Mirabito
Leasing Technical Counsel (LMSB)
Area 1